



Utah State Auditor's Office

Fraud and Internal Control



Management's Responsibility



(AICPA Auditing Standard 109)

“Primary responsibility for the prevention and detection of fraud and error rests with those charged with governance and the management of the entity.”



Control Environment

(AICPA Auditing Standard 109)

“The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.”



Management Must

- ◆ Protect their employees by establishing procedures designed to safeguard funds from loss.
- ◆ Be able to affix responsibility for funds to a particular employee at a point in time, all the time.
- ◆ Safeguard assets while funds are under their control.



Cash Receipting Key Controls

1. An immediate record of cash/checks received.
2. Reconciliation between the immediate record and what was actually deposited in the bank.
3. Bank reconciliation (reconciles bank records to entity's books).



Separation of Duties



Number 2 and 3 key controls CAN NOT be performed by anyone who has access to the cash and checks to be effective.



Separation of Duties

“The amount of fraud in your organization will be determined by how much you separate duties.”



Checks

Checks are almost as easy to steal as
cash!



Small City/Justice Court



Fraud Indicator #1



**Clerk argued with auditor
regarding counting cash
drawer.**

- ◆ **Result: Cash drawer \$165
short**



Internal Control Weaknesses



- ◆ **Ineffective procedure for counting cash drawer at end of day.**
- ◆ **Improper separation of duties and more than one person with access to the money.**

Fraud Indicator #2

Amount of cash and checks received agreed to accounting system but not the bank deposit.

Result: Numerous bank deposits were short, totaling \$60,000 in missing cash and checks.





Internal Control Weakness

Improper separation of duties:

One particular employee took money to the bank and performed bank reconciliation.



What to Look For?

- ◆ In this case, management wouldn't likely notice.
- ◆ Things appear to be running smoothly.
- ◆ That's why having the 3 main controls in place over cash receipting is so important.



Elementary School



Fraud Indicator



The amount of money deposited did not agree to the lunch system records.

- ◆ Result: Between \$3,700 - \$6,700 cash stolen



Internal Control Weakness

- ◆ Separation of Duties – Employee had access to the cash and checks received and the lunch system, prepared the deposit, and had collection responsibilities.
- ◆ Or compensating reconciliations and reviews must be performed.



What to Look For

- ◆ Records don't match
- ◆ Duties not separated
- ◆ Complaints



Cash Disbursing – Key Controls



- ◆ Review and approval of disbursements, including supporting documentation.
- ◆ Separation of Duties



District Court



Fraud Indicators



The court had no indication of problems.

We questioned the propriety of a disbursement.

- ◆ Result: \$10,400 in misappropriations



Internal Control Weaknesses

- ◆ Separation of Duties – Employee approved disbursements, access to blank checks, mails signed checks, records transactions in accounting system, and prepared bank reconciliation.
- ◆ Inadequate approval – Lack of supporting documentation.



What to Look For



- ◆ Duties not separated.
- ◆ Review of canceled checks for alterations.



Non-Profit Charitable Foundation



Fraud Indicators Noticed by the Board

- ◆ The Board had requested information and was not receiving it.
- ◆ Director became uncooperative and gave conflicting information.
- ◆ Bank statements showed suspicious debit card purchases.



Fraud Indicators We Found

We found:

- Incomplete accounting of funds
 - Purchases not related to the playground
 - Bank statements showed transfers to another account
 - Cash/checks received from the public not deposited
- ◆ Result: Approx. \$27,000 misappropriated

Internal Control Weaknesses

Method	Amount Embezzled	Missing Internal Control Activities
Improper purchases – debit card	\$10,046	♦ Separation of duties weaknesses ♦ Lack of independent monitoring/reviews ♦ No independent bank reconciliation ♦ No controls over revenues
Improper purchases – by check	\$3,847	
On-line transfers to personal account	\$6,871	
Revenues – diverted from Pay pal account	\$793	
Revenues – diverted from deposits	\$6,400 (estimated)	



What to Look For



- Employee with full control over the funds – duties not separated.
- Not receiving financial info required/asked for or financial info asked for doesn't meet expectations / conflicting info.



Non-Profit Domestic Abuse Shelter



Fraud Indicator



- ◆ Unreasonable disbursements

Result: \$65,000 in misappropriations



Internal Control Weaknesses

- ◆ Inadequate separation of duties
- ◆ Inadequate documentation and review of disbursements
- ◆ Inadequate Board oversight
- ◆ Inadequate cash receipting controls
- ◆ Inadequate bank reconciliation



What to Look For



- ◆ Employees with full control over funds – duties not separated
- ◆ Unusual disbursements
- ◆ Revenues not what expected



Summary

- ◆ Control Environment
- ◆ Internal Controls



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